No. 08-1207

Supreme Court, U.S.
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In The Supreme Court of the United States

GEOFFREY, INC.,

Petitioner,

v.

COMMISSIONER OF REVENUE,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Judicial Court Of Massachusetts

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

Unable to demonstrate why *certiorari* should not be granted, respondent, instead, misstates several critical aspects of petitioner's arguments and attempts to obfuscate the single, significant issue in this dispute.

The sole question in this case is the continued vitality of the "substantial nexus" prong of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and this Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). That this case involves a single, clean constitutional question makes this case an ideal vehicle for this Court to decide the most significant constitutional question affecting state taxation to come before the Court in decades.

While the "substantial nexus" prong and its physical presence requirement are all that are before the Court, respondent is wrong when it claims that petitioner conceded that it is "doing business" in Massachusetts, that it is subject under state law to the corporate net income tax or that the tax asserted against it by the Commonwealth was fairly apportioned, nondiscriminatory and fairly related to the services provided by the State. Petitioner simply has not pursued those issues under *Complete Auto* for the Court's benefit—to ensure that this case, as it now is presented to the Court, would be devoid of any collateral factual disputes that might undermine this Court's review.

Sixteen state appellate courts have divided on the question presented; respondent does not dispute that fact. That alone should compel this Court's review. But beyond that widespread and mature conflict, this Court's review is necessary because the court below, and many other state courts, have rewritten, misread, and fundamentally ignored this Court's constitutional precedents, and they have shifted the tax burden from its individual voting citizens and businesses that are physically present and thereby place demands on the State's infrastructure to out-of-state businesses that lack any physical presence in the State and thus impose no governmental costs, merely because those out-of-state businesses have earned income having some tenuous connection with that State.

I. CORRECTED STATEMENT OF JURISDICTION

Respondent correctly notes jurisdiction does not lie in this Court under 28 U.S.C. § 1254(1); this Court's jurisdiction is invoked under 28 U.S.C. § 1257(a).

II. BECAUSE THE MASSACHUSETTS SUPREME JUDICIAL COURT'S DECISION CONFLICTS WITH THIS COURT'S PRECEDENT AND THE DECISIONS OF OTHER STATE COURTS, THIS COURT'S INTERVENTION IS CRITICAL

A. The Conflict Between State Courts Is Real And Substantial

Respondent concedes that the state courts are divided (Opp. 15) on an important constitutional issue that profoundly affects this Nation's businesses in a time of economic uncertainty. Rather than acquiesce to *certiorari* being granted, to provide the necessary certainty that both State and businesses alike require, respondent attempts to minimize the conflict among *sixteen* state appellate courts as to the scope of *Bellas Hess* and *Quill* by claiming the cases are old or that subsequent statutes have been enacted to eliminate a physical presence requirement.

Precedents, however, have no automatically expiring "shelf life." Opp. 15 (claiming that certain conflicting decisions of other jurisdictions are "now well past [their] shelf life."). The precedents of state courts, like the precedent of this Court, remain good law until they are overruled. Indeed, two of the precedents respondent criticizes as stale—or "historical anomalies"—were decided within the past decade. Opp. 21.

More significantly, respondent cannot demonstrate that the decisions of the state courts in Tennessee, Michigan, and Texas—all of which impose a physical

presence requirement—are no longer good law. And, as the petition makes clear, the rulings of those courts are binding and have not been revisited. *See* Pet. 21.[1]

Nor is it of any consequence that there might be some contextual differences between the decision of the Tennessee, Michigan and Texas courts and the instant case. Respondents have not disputed, and cannot dispute, that each of those courts held that a physical presence is *necessary* for a jurisdiction to tax. *See Guardian Indus. Corp. v. Department of Treasury*, 499 N.W.2d 349, 356 (Mich. Ct. App. 1993) ("after *Quill* it is abundantly clear that Guardian must show a physical presence within a target state to establish a substantial nexus to it"), *appeal denied*, 512 N.W.2d 846 (Mich. 1994); *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 300 (Tex. Ct. App. 2000) ("While the decisions in *Quill Corp.* and *Bellas Hess* involved sales and use taxes, we see no principled distinction when the basis issue remains whether the state can tax the corporation at all under the Commerce

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[1] The subsequent *unpublished* opinion in *America Online, Inc. v. Johnson*, No. M2001-00927, 2002 WL 1751434 (Tenn. Ct. App. July 30, 2002), could not call *J.C. Penney National Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927 (2000) into doubt, and, in any event, it was not appealed to the Tennessee Supreme Court so it could not overrule prior precedent adopted and approved by that Court. *See* Tenn. S. Ct. R. 4(G)(2). In any event, *America Online* addressed whether the conduct of third parties in the State met the "physical presence test." *See* 2002 WL 1751434, at *3.

Clause. * * * [W]hen the corporation conducts its activity solely through interstate commerce and lacks any physical presence in the state, no sufficient nexus exists to permit the state to assess tax.").

The court below should not be able to evade this Court's review merely because the majority of the sixteen state appellate courts to have addressed this issue have followed the recommendations of their state departments of revenue. This rubber-stamped "everybody else is doing it" (Br. of Tax Executives Institute, Inc. as *Amicus Curiae*, at 12) approach in order to uphold constitutionally unsupportable tax revenue streams cannot be a substitute for reasoned, revenue-blind objective analysis that only this Court, insulated from the political pressures of revenue shortfalls and special elections, can provide.

The conflict is real, current and pressing to businesses and States alike. It speaks volumes that, in the companion case to *Geoffrey*, *Capital One Bank v. Commissioner of Revenue*, 899 N.E.2d 76 (Mass. 2009), No. 08-1169, South Dakota and Virginia have joined Capital One Bank in urging this Court to grant *certiorari* to provide the missing "clarity." Br. of the Commonwealth of Virginia, Joined By South Dakota, as *Amici Curiae*, at 2. Although these States take no position on the issue, they recognize that "[t]he lower courts are divided with respect to the 'nexus' required under the Commerce Clause." *Id.*

B. This Court's Precedent And Not Its *Dicta* Must Be Followed By All Of This Nation's Courts

Even if the physical presence requirement of *Bellas Hess* and *Quill* should be narrowed to just sales and use taxes, review is still required because only this Court, and not the state courts that have divided on this issue, should be permitted to overrule the precedent of this Court. This Court has made clear that its holdings, and not its *dicta*, are the precedent that must be followed. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989) ("If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.").

In their efforts to justify departure from the long-standing precedents of this Court in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), which require a physical presence before a State can assert jurisdiction to tax, the Massachusetts Supreme Judicial Court and the courts of several other States have argued that *Quill* requires less respect because it relied in part on *stare decisis* (Opp. 11-12) and have cited to certain *dicta* in

Quill (Opp. 13).[2] Neither respondent nor the court below, however, cites to any decision of this Court which holds that physical presence is not required for substantial nexus outside the sales and use tax context. Respondent also cites to no decision of this Court holding that the Commerce Clause is tax-specific or industry-specific.

Moreover, the claim that there should be a distinction between sales and use taxes, on the one hand, and income and franchise taxes, on the other, due to relative compliance burdens in nonsensical. No principled justification exists under the Commerce Clause to determine *jurisdiction* based on relative administrative burdens. In any event, the *amici curiae* in this case each examine the relative burdens of sales and use tax compliance to income and franchise tax burdens and have each concluded that the latter taxes place greater burdens on businesses from both compliance and economic vantage points. Br. of *Amici Curiae* Council on State Taxation, National Association of Manufacturers, and National

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[2] The *dicta* is found in two sentences in *Quill*. The first was: "Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule." 504 U.S. at 314. The second was: "In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes." *Id.* at 317.

Marine Manufacturers Association, at 8-15; Br. of Tax Executives Institute, Inc. as *Amicus Curiae*, at 20-21; Br. of *Amicus Curiae* The Sherwin-Williams Company, at 12-19; Br. of *Amicus Curiae* Institute for Professionals in Taxation, at 11-14. Indeed, "[p]erhaps the real dichotomy here may not be between sales and income taxes * * * but how the limitations set forth in the United States Constitution can be avoided to provide the State with a better opportunity to expand its taxing opportunities." *Tax Comm'r v. MBNA Am. Bank, N.A.*, 640 S.E.2d 226, 239 (W. VA. 2006) (Benjamin, J., dissenting).

C. "Substantial Nexus" Does Not Mean "Substantial Revenue"

Review also is necessary because the decision below seeks to fundamentally alter the first prong of the *Complete Auto* framework. Rather than require the State have a "substantial nexus" to the taxpayer, respondent would require only that there be "substantial revenue" generated from within the State.[3] As *Complete Auto* makes clear, however, there

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[3] Respondent thus repeatedly has focused on the amount of royalties petitioner received from Massachusetts businesses. Opp. 10. That amount of royalties received has no bearing on whether petitioner has "substantial nexus" with the State. If anything, the amount of royalties demonstrates the economic significance of this case and the need for this Court's review. Respondent, just one of fifty state departments of revenue, seeks to tax over $33 million of revenues of petitioner. When aggregated across the Nation (and when every business subject

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are separate requirements *all* of which must exist before jurisdiction to tax will satisfy the Commerce Clause, and nowhere does the Constitution look to the amount of revenue generated within the State to determine whether that State has jurisdiction to tax it.

It is for that reason that respondent's comparison of a business owning and leasing a storefront in Massachusetts to a business owning and licensing intellectual property (Opp. 14) demonstrates the need for this Court's immediate review. Respondent's hypothetical reveals the problem of a nexus standard not predicated on physical presence. *Complete Auto's* fourth prong requires that a State tax must "be fairly related to the services provided by the state." 430 U.S. at 279. Since *no* services are provided to the business owning and licensing intellectual property, *no tax* can be fairly related to nonexistent services. Governmental services (*e.g.*, police, fire) are, however, provided with respect to the property physically present in the State.[4] Imaginary services conjured up

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to these inconsistent state court requirements is taken into account), the burden imposed upon the Nation's businesses unquestionably equal billions of dollars.

[4] Indeed, the instant case demonstrates the fallacy of respondent's example. Despite its contention that Geoffrey had "activities in Massachusetts," (Opp. 8) respondent agrees that "Geoffrey's entire business consisted of licensing its intellectual property," which is inherently passive. While respondent claims that petitioner "retained the right to preview and disapprove product samples" and "access to both Massachusetts courts and federal courts located in Massachusetts" (Opp. 10), petitioner

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to justify the imposition of millions of taxes are insufficient to satisfy the fair relationship prong of *Complete Auto*. Indeed, this Court in *Quill* rejected the North Dakota Supreme Court's conclusion that a constitutionally significant nexus was generated by North Dakota's creation of "an economic climate that fosters demand." *Quill*, 504 U.S. at 304 (citation omitted).

The "substantial revenue" standard respondent proposes (and the court below implicitly adopted) is in reality a Due Process nexus standard which, as explained by this Court in *Quill* would apply to any company that "purposefully avails itself of the benefits of an economic market in the forum State." *Quill*, 504 U.S. at 307-308. That standard was advocated by North Dakota in its case against *Quill*, a company that earned almost $1 million of yearly revenue from its North Dakota customers. This Court, however, has held that the Commerce Clause requires more, and there is no reason now for this

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did not use Massachusetts courts or federal courts located in Massachusetts during the years at issue. Pet. App. 8a n.7. No activity was conducted by petitioner in Massachusetts that would support the requirement that "interstate commerce 'pay its own way.'" Opp. 14 (citation omitted). In short, petitioner received *nothing* from Massachusetts or its consumers. It received royalties based on the sales made by affiliates that operated retail stores in Massachusetts, sales which the State subjects to a net income tax levied on those retail affiliates and a sales tax rendered on purchasers of the goods sold by the retailers.

Court to permit state courts to retreat from that precedent.

D. The Burdens Imposed By The Decision Below Are Not Speculative

Respondent's attempts to minimize the burdens on interstate commerce of the ruling below are belied by the numerous *amicus* briefs in support of Geoffrey's petition and in support of the companion case, *Capital One*. These *amici* substantiate the very real and current burdens businesses face if this Court does not intervene:

- "[T]his Court's review is urgently needed because departures from the physical presence rule and the resulting uncertainty over the jurisdictional grounds of state taxation have themselves generated an impermissible burden on interstate commerce." Br. of *Amici Curiae* Council on State Taxation, National Association of Manufacturers, and National Marine Manufacturers Association, at 3.

- "The holdings of the Massachusetts court in *Capital One* and the instant case cast an ominous shadow over the protections accorded interstate businesses by the Commerce Clause of the Constitution." Br. of Tax Executives, Inc. as *Amicus Curiae*, at 7.

- "This issue is the most significant state and local tax question pending today. The associated tax and compliance cost implications, in the billions of dollars, are of special concern to small businesses because of the resulting disproportionate impact they occasion." Br. of *Amicus Curiae* Institute for Professionals in Taxation, at 2.

- "[T]he ambiguity surrounding the issue of state income tax nexus interferes with corporations' abilities to conduct themselves in the interstate marketplace." Br. of *Amicus Curiae* The Sherwin-Williams Company, at 22.

- "If states are allowed to tax the income of citizens and corporations of other states or nations based on this nebulous economic nexus standard, the delicate balance carefully established by numerous international tax treaties will be upset, causing serious disruption to the expectations of international businesses that engage in commerce with U.S. persons." Br. of the Clearing House Association, The National Foreign Trade Council, The Organization for International Investment, The Securities Industry and Financial Markets Association, and the United States Council for International Business as *Amici Curiae*, at 3, filed in *Capital One Bank v. Commissioner of Revenue*, No. 08-1169.

- "[T]he States need clarity in the law. At present that clarity is missing." Br. of the Commonwealth of Virginia, Joined by South Dakota, as *Amici Curiae*, at 2, filed in *Capital One Bank v. Commissioner of Revenue*, No. 08-1169.

E. The Absence Of Congressional Intervention Makes This An Issue For This Court To Decide

Petitioner does not dispute that this is a question that Congress can, if it so chooses, decide. Congress is free to adopt a jurisdictional threshold under the Commerce Clause that is different and more burdensome than the physical presence requirement set out by this Court in *Quill*. Despite the passage of 17 years from *Quill* (and more than 40 years since *Bellas Hess*), however, Congress has not done so.

The absence of any word from Congress should not permit the States to enact new state taxes that retreat from this Court's Commerce Clause precedent. As this Court has recognized in other contexts, "[a]bsent 'a clear expression of approval by Congress,' any relaxation in the restrictions on state power otherwise imposed by the Commerce Clause unacceptably increases 'the risk that unrepresented interests will be adversely affected by restraints on commerce.'" *Maine v. Taylor*, 477 U.S. 131, 139 (1986) (citation omitted). Because Congress has not spoken, there has been no clear statement that would justify the decision below.

In any event, it is the *dicta* in this Court's decision in *Quill* that is the genesis of the question of whether its stated physical presence standard applies beyond sales and use taxes. This Court is therefore in the best position to answer that question and determine whether the States have properly supplanted the Court's physical presence Commerce Clause standard with an economic presence test.

CONCLUSION

For the reasons set forth above and in the petition, the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

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